Office of Chief Counsel
Internal Revenue Service

memorandum

CC:MSR:AOK:OKL:TL-N-6911-98
CGMcLoughlin

date: JUN 0 8 1999

to: Chief, Examination Division, Arkansas-Oklahoma District
Attn: Dan Gray

from: District Counsel, Arkansas-Oklahoma District, Oklahoma City

subject: Request for Advisory Opinion

Taxpayer: [redacted]
EIN: [redacted] (previously [redacted]

[redacted]
(formerly [redacted]
[redacted])
EIN: [redacted]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

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Although we informally coordinated this matter with the National Office, the advisory is subject to the review procedures of CCDM (35)3(19)4(4). The CCDM procedures require us to transmit a copy of the memorandum to the National Office. The National Office has ten days from receipt of our memorandum to respond. The National Office may extend the review period if necessary. We will keep you informed of any delays.

DISCUSSION

We are responding to your November 5, 1998 memorandum requesting our views on three claim issues currently being examined. There, you specifically asked: (a) whether costs incurred in paying bodily injury/property damage claims can qualify as specified liability losses under I.R.C. §§ 172(b)(1)(C) and 172(f)(1)(B)(ii); (b) whether costs incurred in paying workers compensation claims can qualify as specified liability losses under I.R.C. §§ 172(b)(1)(C) and 172(f)(1)(B)(i); and (c) whether the government's position on capitalization of investment banking fees has been altered by the Seventh Circuit's opinion in A.E. Staley Mfg. Co. & Subs. v. Commissioner, 119 F.3d 482 (7th Cir. 1997). We respond to each issue separately below.

I.R.C. § 172(f)

Facts

[redacted] and [redacted] have been involved in the regional long-haul trucking business for many years. Until [redacted], [redacted] and [redacted] were separate consolidated return groups. Each group elected to file consolidated income tax returns under Treas. Reg. § 1.1502-0 et seq. On [redacted], [redacted] acquired [redacted]. The acquisition terminated the [redacted] consolidated return group. [redacted] filed a final group return for the short taxable year ending [redacted]. The former [redacted] group members became part of the [redacted] consolidated return group. During all relevant periods, both the [redacted] and the [redacted] consolidated return groups consistently used the accrual method of accounting.

In the course of operating their trucking businesses, [redacted] and [redacted] incur various routine liabilities. The obligation to make workers compensation liability payments is one type of routine liability. Another type of routine liability stems from damages to property and bodily injury claims arising from the trucking operations.

The workers compensation liabilities arise when an employee is injured on the job or develops a job related illness or injury. Under the state workers compensation laws where the companies operate, [redacted] and [redacted] are required to compensate their injured workers under the workers compensation systems. In most instances, the job related injuries are directly related to a particular event, such as an accident. In some cases the job related injuries stem from a physical degeneration which occurred over a period of time. Sometimes the companies make lump sum payments to injured workers under the workers compensation systems. In other cases, the workers compensation obligations are on-going and must be paid monthly or quarterly over an extended period of time. Usually, there is some time delay between the incident which generated the liability and the date of the payment to the injured worker. The delay can extend over several years. Both [redacted] and [redacted] keep records tracking the date of the worker's injury and the date of each payment.

The routine property damage and bodily injury claims cover simple tort claims of unrelated third parties. The liabilities typically arise from traffic accidents caused by the companies' employees. The claims normally arise from a particular event, such as a traffic accident. As with the workers compensation claims, normally there is a delay between the event which generates the liability and the payment of the claim. Often the liabilities are satisfied with a lump sum payment, but sometimes payments on a particular claim are made over several years. Like the workers compensation claims, [redacted] and [redacted] maintain records identifying the date the claim arose and the date of any payments on the claim.

[redacted] claimed a consolidated net operating loss on its final return for the short taxable year ending [redacted]. The company filed a Form 1139 carrying a portion of the claimed net operating loss to the taxable years [redacted], [redacted] and [redacted]. [redacted] also filed a Form 1120X for the taxable year [redacted] attempting to carryback a portion of the net operating loss as a 10-year carryback under I.R.C. § 172(b)(1)(C). The claimed carryback to the taxable year [redacted] freed-up certain credits which [redacted] attempted to carryback to the taxable years [redacted], [redacted] and [redacted].

[redacted] filed similar claims for a net operating loss reported on its taxable year [redacted] return. [redacted] filed a Form 1139 carrying back a portion of the net operating loss to its taxable years [redacted], [redacted] and [redacted]. [redacted] also filed a Form 1120X attempting to claim a 10-year carryback under I.R.C. § 172(b)(1)(C) to the taxable year [redacted].

The 10-year carrybacks are supposed to be attributable to the workers compensation payments and property damage/bodily injury claims paid by [redacted] and [redacted] in the taxable years [redacted] and [redacted], respectively. Examination Division has confirmed that: (a) the payments at issue are attributable to workers compensation claims or property damage/bodily injury claims; and (b) the liabilities for the claims arose from acts which occurred at least three years prior to the taxable year of payment. Examination Division has questioned whether these types of payments qualify for the 10-year carryback provisions of I.R.C. § 172(b)(1)(C).

Analysis

For the years at issue,[1] a taxpayer generally may carry a net operating loss back 3 taxable years preceding and forward 15 taxable years after the loss year. I.R.C. § 172(b)(1)(A). But, a "specified liability loss" may be carried back to the 10 taxable years preceding the loss year. I.R.C. § 172(b)(1)(C).

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[1] I.R.C. § 172(b)(1)(A) was amended in 1997 to provide for 2-year carryback and 20-year carryforward periods, effective for net operating losses for taxable years beginning after August 5, 1997. Section 1082(a) and (c) of the Taxpayer Relief Act of 1997, P.L 105-34.

I.R.C. § 172(f)(1) defines a "specified liability loss" as:[2]

In general. The term "specified liability loss" means the sum of the following amounts to the extent taken into account in computing the net operating loss for the taxable year:

(A) Any amount allowable as a deduction under I.R.C. § 162 or § 165 which is attributable to --

(i) product liability, or

(ii) expenses incurred in the investigation or settlement of, or opposition to, claims against the taxpayer on account of product liability.

(B) Any amount (not described in subparagraph (A)) allowable as a deduction under this chapter with respect to a liability which arises under a Federal or State law or out of any tort of the taxpayer if --

(i) in the case of a liability arising out of a Federal or State law, the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year, or

(ii) in the case of a liability arising out of a tort, such liability arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of the taxable year.

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[2] The tax provisions of the Tax and Trade Relief Extension Act of 1998 amended I.R.C. § 172(f)(1)(B)(i) and specifically limited the availability of the 10-year carryback to certain types of liabilities arising under federal or state law. The amendment is effective for net operating losses arising in taxable years ending after October 21, 1998. Sec. 3004(b), HR 4328.

I.R.C. § 172(f)(2) limits the amount of the specified liability loss for any taxable year to the amount of the net operating loss for the taxable year. In addition, an amount described in I.R.C. § 172(f)(1)(B) shall not be taken into account as a specified liability loss unless the taxpayer used an accrual method of accounting throughout the period or periods during which the acts or failures to act giving rise to such liability occurred. I.R.C. § 172(f)(1)(B).

Congress first enacted the provisions of I.R.C. § 172(f)(1)(B) in Section 91(d) of the Tax Reform Act of 1984 ("1984 Act"). 1984-3 C.B. (Vol. 1) 1, 114-115. The language was then included in I.R.C. § 172(k). The caption to I.R.C. § 172(k) described the covered items as deferred statutory or tort liability deductions. The other substantive provisions added by Section 91 of the 1984 Act are as follows:

Subsection (a) - Economic performance rules (I.R.C. § 461(h));

Subsection (b) - Rules for mining and solid waste reclamation and closing costs (I.R.C. § 468);

Subsection (c) - Rules for nuclear decommissioning costs (I.R.C. § 468A);

Subsection (e) - Conforming amendment to I.R.C. § 461(f) relating to contested liabilities; and

Subsection (f) - Inclusion in income of nuclear decommissioning costs included in the taxpayer's rate base (I.R.C. § 88).

1984-3 C.B. (Vol. 1) 1, 106-117.

Prior to the 1984 Act, Treas. Reg. § 1.461-1(a)(2) generally treated an accrual method taxpayer as incurring a liability for federal income tax purposes when the following all-events test was satisfied:

(1) all the events had occurred that established the fact of the liability, and

(2) the amount of the liability could be determined with reasonable accuracy.

By the 1980's, the government became concerned that the two-pronged all-events test could allow accrual-method taxpayers to deduct liabilities long before the liabilities actually had to be satisfied by payment or other performance. Examples included the accrual of restoration costs by strip miners, the costs of decommissioning nuclear facilities and structured settlements of tort or other liability claims. Under the existing case law, accrual method taxpayers could arguably deduct each of these classes of liabilities many years before actual payment was required. In light of these concerns, the government sought a legislative solution to the problem.

The government proposed the addition of an economic performance requirement to the all-events test. See Staff of the Joint Committee on Taxation, Summary of Administration's Revenue Proposals in the Fiscal Year 1985 Budget Proposal 31 (Comm. Print 1984). Under the proposed change, the all-events test was to be modified. Deductions would not be permitted under the all-events test until services were performed, the use of property actually occurred, or in the case of workers compensation or similar liabilities, the liability was actually satisfied. Id. The potential mismatching resulting from imposing an economic performance requirement could result in overtaxing taxpayers in certain situations. For example, if the taxpayer had no gross income for the taxable year in which the economic performance requirement is satisfied (nor any gross income in the taxable years covered by the normal 3-year net operating loss carryback rule), the taxpayer would lose the immediate benefit of the deduction when economic performance occurred.

To remedy this potentially unfavorable result, the government proposed liberalizing the net operating loss carryback provisions for deductions deferred because of economic performance:

> We recognize that requiring deductions for future expenses to be taken in the year of economic performance also requires that the net operating carryback rules be amended to insure that taxpayers are not overtaxed. Our proposals provide for extension of the carryback period in appropriate circumstances to insure that the deferred expenses will be able to be fully utilized.

> Generally expenses attributable to liabilities arising more than 3 years prior to economic performance will be permitted to be carried back for a period not to exceed 10 years, subject to certain transition rules. Special carryback rules might be appropriate for certain expenses to be paid in the future such as nuclear power plant decommissioning costs.

Id. at 7.

Congress adopted the government's proposed economic performance requirement by enacting I.R.C. § 461(h) in Section 91(a) of the 1984 Act. 1984-3 C.B. (Vol. 1) 1, 106. Section 91(d) of the 1984 Act also enacted the provision allowing the 10-year carryback for deferred statutory or tort liability losses. 1984-3 C.B. (Vol. 1) 1, 114-115. The discussion of the new 10-year carryback provision appears in the same section of the committee reports where I.R.C. § 461(h) is described.

The House and Senate Reports to the 1984 Act both provide only the same single specific example of a type of deduction that could generate a net operating loss eligible for the proposed new 10-year carryback. The House Report provides:

> This rule applies in the case of a liability under Federal or State law, if the act (or failure to act) occurs at least 3 years before the beginning of the taxable year; and in the case of a tort liability, if the liability arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of the year. For example, this rule would apply if a taxpayer incurred a tort liability for failure to protect another person from a hazardous substance, such as chemical waste, over an extended period of time.

H.R. Rep. No. 432 (Part 2) 98th Cong., 2d Sess. 1256 (1984).

Although the House and Senate Report describe the operation of the proposed new 10-year net operating loss carryback provision, neither of these reports discuss the reason for its enactment. The Conference Report, however, provides:

> The House bill provides a 10-year carryback for net operating losses attributable to certain liabilities deferred under these provisions. ...

> The provisions of the bill generally apply to expenses incurred (without regard to the economic performance requirement) after the date of enactment. ...
>
> Conference agreement
>
> The conference agreement generally follows the House bill, . . .

H.R. (Conf.) Rep. No. 861, 98th Cong., 2d Sess. 872-73 (1984), 1984-3 C.B. (Vol. 2) 1, 126-127.

In Sealy Corp. v. Commissioner, 107 T.C. 177 (1996), aff'd, 171 F.3d 655 (9th Cir. 1999), the taxpayers claimed that the portion of net operating losses generated by deductions for legal, accounting, and other professional fees qualified as specified liability losses under I.R.C. § 172(f)(1)(B). The taxpayers incurred: (a) legal, accounting, and other professional fees for services in connection with an audit of several federal income tax returns; and (b) incurred accounting fees to comply with financial reporting requirements under the Securities and Exchange Act of 1934 and the Employee Retirement Income Security Act of 1974.

There, the Tax Court concluded the deductions for the legal, accounting, and other professional fees did not generate specified liability losses under I.R.C. § 172(f)(1)(B). The Court found the liabilities at issue did not arise under Federal or State law within the meaning of I.R.C. § 172(f)(1)(B). The Court determined that the Federal laws cited by the taxpayers did not establish their liability to pay the fees at issue. Instead, the taxpayers' liability for those amounts did not arise until the taxpayers contracted for and received the services. The Tax Court noted that the taxpayers choice of the means of compliance, and not the regulatory provisions, determined the nature and amount of their costs. If the taxpayers had failed to comply with the auditing and reporting requirements or had not obtained the particular services at issue, their liability would have been in amounts not measured by the value of the services. Id. at 184.

The Tax Court also determined that its interpretation of I.R.C. § 172(f)(1)(B) was consistent with the statute's legislative history. In the Tax Court's view, the legislative history to the 1984 Act suggested that Congress intended the new 10-year carryback provision to apply only to deductions deferred by the economic performance rules. Id. at 185. Because the fees at issue became deductible when the liability for such fees was created through rendering services, the economic performance rules did not defer deductions for such fees.

Lastly, the Tax Court used the statutory construction rule of ejusdem generis to construe the 10-year carryback provision. Applying that rule, the Court found that Congress intended only a narrow class of liabilities to be eligible for 10-year carryback treatment. The Court described the limited class of specified liability losses as follows:

> I.R.C. § 172(f) provides a 10-year carryback for product liability expenses, tort losses, and nuclear power plant decommissioning costs, among other specified liability losses. We think Congress intended the 10-year carryback for liability losses under I.R.C. § 172(f)(1)(B) to apply to a relatively narrow class of liabilities similar to the others identified by the statute. Under the ejusdem generis rule of statutory construction, general words that follow the enumeration of specific classes are construed as applying only to things of the same general class as those enumerated. (citations omitted) We think that the costs at issue here are routine costs and are not of the same general type as those other categories.

Id. at 186.

The application of these principles to workers compensation payments is far from clear. The government's comprehensive legal position with respect to worker's compensation is still under development. (b)(5)(AC), (b)(7)a [redacted]

(b)(5)(AC), (b)(7)a [redacted]

[3] This position is supported by recent legislative action. The tax provisions of the Tax and Trade Relief Extension Act of 1998 amended I.R.C. § 172(f)(1)(B)(i), limiting the 10-year carryback to certain types of liabilities arising under federal or state law. Workers compensation liabilities covered by the I.R.C. § 461(h)(2)(C)(i) economic performance rules are specifically included in the legislation. The amendment is effective for net operating losses arising in taxable years ending after October 21, 1998. Sec. 3004(b), HR 4328.

The government may eventually take the position that (b)(5)(AC), (b)(7)a [redacted]

[redacted]'s and [redacted]'s bodily injury/property damage claims are another matter. Tort liabilities are subject to slightly different rules under I.R.C. § 172(f)(1)(B)(ii). To qualify for a 10-year carryback under I.R.C. § 172(f)(1)(B)(ii), a liability must arise out of a tort and must arise out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of the taxable year. I.R.C. § 172(f)(1)(B)(ii). These types of liabilities are frequently described as continuing torts since no single event generates the liability. Rather, the liability arises from a series of events occurring over a period of time.

[redacted]'s and [redacted]'s bodily injury/property damage claims do not qualify as continuing torts. The tort claims at issue arose more than 3 years prior to the year of payment. However, in each instance a single event occurring in one taxable year generated the tort liability. The liability did not arise from a series of actions. The tort liabilities will not qualify as specified liability losses under I.R.C. § 172(f)(1)(B)(ii).

Capitalization of Takeover Costs

Facts

In [redacted] [redacted] commenced an unsolicited offer to purchase [redacted]'s outstanding stock for $[redacted] per share. In [redacted], [redacted] agreed to be acquired by a white knight, [redacted]") for $[redacted] per share. During the weeks between the unsolicited offer and agreement with [redacted], the taxpayer took a number of steps: (a) to evaluate the [redacted] offer; and (b), if it determined the offer was not in the best interests of the shareholders, to defend against the offer.

During this period, [redacted] incurred expenses associated with the aborted takeover attempt. The company incurred investment banking fees in obtaining financial advice and fairness opinions on the various takeover proposals. It also incurred legal fees and expenses: (a) for advice on the legal rights and obligations of the company with respect to tender offers; (b) for assistance in formulating defensive options to the unsolicited takeover; (c) for defending against and initiating litigation associated with the unsolicited takeover; and (d) for the preparation of documents and securities filings needed to consummate the [redacted] acquisition. The company also incurred expenses related to securities filings, proxy solicitations, accounting fees and recording fees associated with the transactions.

[redacted]'s two largest fees associated with the aborted hostile takeover were $[redacted] in legal fees paid to [redacted] and $[redacted] in investment banking fees paid to [redacted]. The taxpayer deducted these and other fees, claiming they were associated with the aborted hostile takeover. The taxpayer deducted a total of $[redacted] in the [redacted] taxable year and $[redacted] in the [redacted] taxable year. [redacted] also incurred fees in the successful acquisition of the taxpayer by [redacted]. The taxpayer capitalized all of the latter category of expenses.

Examination Division audited the deductions and partially disallowed the [redacted] and [redacted] fees. Examination Division determined that 66⅔ of the [redacted] fees and [redacted]% of the [redacted] fees had created long term benefits for the taxpayer. Relying on INDOPCO, Inc. v. Commissioner, 503 U.S. 79 (1992), Examination Division disallowed [redacted]% of the attorneys and all of the investment banking fees. During the audit, [redacted] provided an affidavit allocating [redacted]% of its fees to the hostile takeover. [redacted] also provided a similar affidavit allocating [redacted]% of the fees to the hostile takeover.

The taxpayer protested these determinations to the Appeals Office. There, [redacted] reached an agreement to settle the disputed fees. Based on the hazards of litigation, the taxpayer offered to capitalize [redacted]% of the [redacted] fees and [redacted]% of the [redacted] fees. The Appeals Office accepted the settlement proposal, believing it appropriately gauged the hazards of litigation. The parties implemented the settlement using a Form 870-AD.[4]

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[4] A net operating loss carryover was the only other significant issue under Appeals Office consideration. The net operating loss issue was a whipsaw issue with a related taxpayer. The related taxpayer later agreed to the adjustment and the Appeals Office conceded the net operating loss issue here.

Recently, the taxpayer again raised the INDOPCO issue by asserting a claim. In the claim, [redacted] asserts that all of the attorney's fees and the investment banking fees (not just the amounts agreed to in the Appeals Office settlement) are deductible. The claim is based on the Seventh Circuit's opinion in A.E. Staley Mfg. Co. & Subs. v. Commissioner, 119 F.3d 482 (7th Cir. 1997). You have asked us whether the government's position on takeover expenses has been altered by A.E. Staley.

Analysis

The deductibility of attorneys fees and investment banking fees has been the subject of much litigation in recent years. To be deductible by an accrual basis taxpayer, an expenditure must be: (a) an expense; (b) an ordinary expense; (c) a necessary expense; (d) incurred during the taxable year; and (e) made to carry on a trade or business. Commissioner v. Lincoln Sav. & Loan Assoc., 403 U.S. 345 (1971). An expense which creates a separate and distinct asset is not an ordinary expense. Id. at 354. An expense which generates a significant long-term benefit that extends beyond a taxable year also fails to qualify as an ordinary expense. INDOPCO, 503 U.S. at 87-88.

In INDOPCO, the Supreme Court was faced with the deductibility of investment banking fees incurred in a friendly takeover. There the target corporation engaged an investment banking firm to evaluate an offer, to render a fairness opinion and to assist generally in the event a competing hostile tender offer emerged. There, the Supreme Court found the professional expenses fell within the longstanding rule that expenses directly incurred in reorganizing or restructuring a corporate entity for the benefit of future operations are not deductible under I.R.C. § 162. INDOPCO, 403 U.S. at 90. The Court found the expenditures had to do with the betterment of the corporation's operations and were expected to generate long-term benefits for many years. Thus, the professional expenses were not immediately deductible under I.R.C. § 162. Id.

The Supreme Court's ruling in INDOPCO was subsequently applied by the Tax Court in Victory Mkts., Inc. v. Commissioner, 99 T.C. 648 (1992). There, the taxpayer again sought to deduct investment banking fees for providing advice and services in connection with a corporate takeover. Although the taxpayer claimed the expenses were deductible as hostile takeover expenses which created no long term benefits, the Court rejected these contentions. The Tax Court specifically found the takeover was not hostile and that it generated long-term benefits. Id. at 662-665. Accordingly under the INDOPCO doctrine, the taxpayer could not deduct the investment banking fees. Id. at 665.

The Tax Court followed a similar course in A.E. Staley Mfg Co. & Subs. v. Commissioner, 105 T.C. 166 (1995), rev'd, 119 F.3d 482 (7th Cir. 1997). That case also involved the deductibility of investment banker's fees and expenses in a corporate takeover. The taxpayer claimed the fees and expenses were deductible because a hostile takeover was involved. The Tax Court followed its approach in Victory Markets and found, despite the hostile nature of the takeover, the taxpayer derived significant long-term benefits from the change in ownership. A.E. Staley, 105 T.C. at 196-198. Since the investment banking fees and expenses were incurred incident to the change, the Court required those expenditures to be capitalized under the INDOPCO doctrine. Id. at 197-198. The fact that the taxpayer was involved in a hostile takeover did not change the results. Id. at 198.

The Seventh Circuit rejected much of the Tax Court's determination on appeal. The appellate court, in general, did not treat the fees as costs associated with facilitating a capital transaction. A.E. Staley, 119 F.3d at 491-492. Instead, the Seventh Circuit characterized the fees as expenditures incurred in defending a business and its policies from attack. A.E. Staley, 119 F.3d at 489-491. The Seventh Circuit then allowed a deduction for the bulk of the fees, applying a long line of cases which permit I.R.C. § 162 deductions for expenses used protect an established business. A.E. Staley, 119 F.3d at 488.[5]

Despite the Seventh Circuit's opinion in A.E. Staley, the government has not altered its position on the fees at issue here. Following the Supreme Court's ruling in INDOPCO, the government generally treats such fees as costs incurred incident to a change in ownership which generate significant long-term benefits to the taxpayer. As discussed above, this position has been accepted by the Tax Court in Victory Markets and A.E. Staley.[6] The position applies whether the costs are incurred in a friendly transaction or

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[5] The appellate court also allowed an abandonment loss for certain fees associated with alternative defensive transactions later abandoned by the taxpayer. A.E. Staley, 119 F.3d at 490-491. The Tax Court had earlier rejected the abandonment loss theory, based on the taxpayer's failure to prove portions of the fees could be allocated to specific and distinct abandoned projects. A.E. Staley, 105 T.C. at 200.

[6] The Tax Court also recently applied the same approach to preparatory expenses which: (a) enabled the taxpayer to achieve the long-term benefits sought from a proposed transaction; and (b) were incurred prior to any formal decision to enter into the transaction. Norwest Corp. v. Commissioner, 112 T.C. No. 9 (1999).

in a hostile takeover. While the existence of long-term benefits must be examined on a case-by-case basis, we see nothing here indicating a lack of long-term benefits from the change in ownership. If anything, the facts seem to justify a greater percentage of fee disallowance than agreed to in the Appeals Office settlement.

There is another reason in this case to disallow the recent claim. The Appeals Office and the taxpayer implemented the settlement using a Form 870-AD. By its terms, a Form 870-AD specifically provides that the case shall not be reopened in the absence of fraud, malfeasance, concealment or misrepresentation of a material fact. The form further provides that, except for amounts attributed to carrybacks, no claim for refund or credit shall be filed or prosecuted for the taxable years covered by the Form 870-AD. Assuming the statute of limitations on assessment has expired, the Form 870-AD should preclude the taxpayer from reopening the matter now.

A Form 870-AD is not a formal closing agreement under I.R.C. § 7121 or a formal offer in compromise under I.R.C. § 7122. The courts have consistently ruled that, absent estoppel, a Form 870-AD is not binding on the parties. Whitney v. United States, 826 F.2d 896 (9th Cir. 1987); Elbo Coals, Inc. v. United States, 763 F.2d 818 (6th Cir. 1985); Stair v. United States, 516 F.2d 560 (2d Cir. 1975). However, the terms of a Form 870-AD, which explicitly prohibit a later refund claim, may equitably preclude a taxpayer from pursuing a refund action. Elbo Coals, 763 F.2d at 820-821; Stair, 516 F.2d at 564-565.

In Cain v. United States, 255 F.2d 193 (8th Cir. 1958), the Eighth Circuit[7] recognized the possible application of estoppel to settlements. There, the taxpayer had entered into a multi-taxpayer settlement involving four taxable years. The settlement documentation and surrounding circumstances reflected the parties desired to reach a final settlement involving all taxpayers and all taxable years. The actual settlement documents contained no specific language waiving any future refund claims. After the statute of limitations for assessment had run, the taxpayer brought an action seeking a refund for two of the four taxable years.

The Eighth Circuit determined the facts in that case provided adequate grounds to invoke estoppel and to preclude the taxpayer from obtaining a refund. Cain, 255 F.2d at 199. In the Eighth Circuit's view, estoppel is appropriate where: (a) the parties reach a settlement while the assessment statute is open; and (b) the government later allows the assessment statute to expire to

[7] [redacted] is located in the Eighth Circuit.

put a seal of finality on the settlement agreement. Id. at 198-199. The Eighth Circuit's analysis should apply equally to a case settled with a Form 870-AD. If [redacted] waited until after assessment statutes expired to assert its new claim, the government could invoke estoppel as an additional basis for denying the claim.

Please contact Glenn McLoughlin at (405) 297-4803 if you have any questions. We are closing our file.

Michael J. O'Brien

MICHAEL J. O'BRIEN
District Counsel

cc: ARC (TL), Midstates Region
ARC (LC), Midstates Region